Supreme Court, U.S.
FILED
MAY 22 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-489

In the Supreme Court of the United States

OCTOBER TERM, 1986

W. T. LANGLEY and MARY ANN GRIMES LANGLEY,
PETITIONERS

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

CHARLES FRIED
Solicitor General

JOHN C. MURPHY, JR.
General Counsel

ANN S. DUROSS
Assistant General Counsel

LAWRENCE F. BATES
Counsel

JANE ROSSOWSKI
Attorney
Federal Deposit Insurance Corporation
Washington, D.C. 20429

LAWRENCE G. WALLACE
Deputy Solicitor General

RICHARD G. TARANTO
Assistant to the Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

QUESTION PRESENTED

The Federal Deposit Insurance Corporation (FDIC) seeks to enforce a note acquired from a failed bank. The debtors on the note allege that, as part of an unrecorded arrangement that varied the terms of the written instrument, the bank orally made fraudulent factual representations that the debtors relied on in agreeing to the loan transaction. The question presented is whether 12 U.S.C. 1823(e) or federal common law precludes the debtors from relying on the alleged oral understandings to invalidate their written loan obligation.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statute involved	2
Statement	2
Summary of argument	9
Argument:	
I. 12 U.S.C. 1823(e) bars petitioners' defense to their written loan obligation based on unrecorded representations allegedly relied on in assuming the obligation	12
A. Section 1823(e)'s language broadly encompasses all unwritten understandings material to a written loan obligation	13
B. The core functions of the FDIC require that the FDIC be able to rely on the written records of insured banks	15
C. The background and legislative history of Section 1823(e) demonstrate Congress's intent that the FDIC be able to rely on written bank records	19
D. Section 1823(e) bars petitioners' reliance on any unwritten representations to vary the terms of their written obligation to the detriment of the FDIC	29
II. Even if Section 1823(e) does not bar petitioners' defense to their written obligation, federal common law precludes petitioners from asserting the defense	36
A. Federal common law may refuse to permit a debtor's defense to a note held by the FDIC even if Section 1823(e) does not bar the defense	36

Argument—Continued: Page

B. Federal common law precludes petitioners' defense to their note 41

1. Petitioners' defense is barred by the *D'Oench* decision because petitioners lent themselves to an undisclosed arrangement that was likely to mislead bank examiners 41

2. Federal common law must decline to permit petitioners' defense in order to protect the federal deposit insurance program 44

Conclusion 47

TABLE OF AUTHORITIES

Cases:

Black v. *FDIC*, 640 F.2d 699 (5th Cir.), cert. denied, 454 U.S. 838 (1981) 35

British Columbia Investment Co. v. *FDIC*, 420 F. Supp. 1217 (S.D. Cal. 1976) 42

Bryan v. *Bartlett*, 435 F.2d 28 (8th Cir. 1970), cert. denied, 402 U.S. 915 (1971) 20

Chatham Ventures, Inc. v. *FDIC*, 651 F.2d 355 (5th Cir. 1981), cert. denied, 456 U.S. 972 (1982) 35, 43

City of Milwaukee v. *Illinois*, 451 U.S. 304 (1981) 40

D'Oench, Duhme & Co. v. *FDIC*, 315 U.S. 447 (1942) 11, 20, 21, 22, 23, 37, 39, 43

Dietrick v. *Greaney*, 309 U.S. 190 (1940) 20, 21, 44

Dominguez v. *FDIC*, 90 F.R.D. 595 (D.P.R. 1981) .. 39

Doty v. *Love*, 295 U.S. 64 (1935) 18

FDIC v. *Alker*, 151 F.2d 907 (3d Cir. 1945), cert. denied, 327 U.S. 799 (1946), reh'g denied, 377 U.S. 920 (1964) 24

FDIC v. *Armstrong*, 784 F.2d 741 (6th Cir. 1986) 34

FDIC v. *Berr*, 643 F. Supp. 357 (D. Kan. 1986) 42

FDIC v. *Castle*, 781 F.2d 1101 (5th Cir. 1986) 35

FDIC v. *de Jesus Velez*, 678 F.2d 371 (1st Cir. 1982) 34, 35, 39, 43

Cases—Continued: Page

FDIC v. *First National Finance Co.*, 587 F.2d 1009 (9th Cir. 1978) 40, 43
FDIC v. *Fonseca*, 795 F.2d 1102 (1st Cir. 1986) 35
FDIC v. *Gardner*, 606 F. Supp. 1484 (S.D. Miss. 1985) 35
FDIC v. *General Investments Inc.*, 522 F. Supp. 1061 (E.D. Wis. 1981) 39
FDIC v. *Hatmaker*, 756 F.2d 34 (6th Cir. 1985) .. 8, 12, 30, 31, 35
FDIC v. *Hoover-Morris Enterprises*, 642 F.2d 785 (5th Cir. 1981) 35, 39
FDIC v. *Investors Associates X., Ltd.*, 775 F.2d 152 (6th Cir. 1985) 39, 42, 43, 44
FDIC v. *Langley*, 792 F.2d 547 (5th Cir. 1986) 7
FDIC v. *Lattimore Land Corp.*, 656 F.2d 139 (5th Cir. 1981) 30
FDIC v. *MM & S Partners*, 626 F. Supp. 681 (N.D. Ill. 1985) 39, 45
FDIC v. *McClanahan*, 795 F.2d 512 (5th Cir. 1986) 38
FDIC v. *Merchants National Bank*, 725 F.2d 634 (11th Cir.), cert. denied, 469 U.S. 829 (1984) .. 12, 18, 32, 34, 35
FDIC v. *O'Neil*, 809 F.2d 350 (7th Cir. 1987) 12, 30, 34, 35
FDIC v. *Philadelphia Gear Corp.*, No. 84-1972 (May 27, 1986) 15, 16, 37
FDIC v. *Powers*, 756 F. Supp. 1167 (N.D. Ill. 1983), aff'd, 753 F.2d 1076 (7th Cir. 1984) 35, 39
FDIC v. *Rodenberg*, 571 F. Supp. 455 (D. Md. 1983) 12-13
FDIC v. *Timbalier Towing Co.*, 497 F. Supp. 912 (N.D. Ohio 1980) 39, 42
FDIC v. *Van Laanen*, 769 F.2d 66 (10th Cir. 1985) 39-40, 43
FDIC v. *Vineyard*, 346 F. Supp. 489 (N.D. Tex. 1972) 39
FDIC v. *Waldron*, 630 F.2d 239 (4th Cir. 1980) .. 35
FDIC v. *Wood*, 758 F.2d 156 (6th Cir. 1985), cert. denied, No. 84-1952 (Nov. 4, 1985) 18

Cases—Continued: Page

First State Bank v. *United States*, 599 F.2d 558 (3d Cir. 1979), cert. denied, 444 U.S. 1013 (1980) 16
Gunter v. *Hutcheson*, 674 F.2d 862 (11th Cir.), cert. denied, 459 U.S. 826 (1982) 8, 18, 19, 30, 31, 32, 33, 39
Illinois v. *City of Milwaukee*, 406 U.S. 91 (1972) .. 37
Merrill Lynch, Pierce, Fenner & Smith v. *Curran*, 456 U.S. 353 (1982) 40
Mobil Oil Corp. v. *Higginbotham*, 436 U.S. 618 (1978) 40
Mount Vernon Trust Co. v. *Bergoff*, 272 N.Y. 192, 5 N.E.2d 196 (1936) 39
National Bank of North America v. *Around the Clock Truck Service*, 58 Misc.2d 660, 296 N.Y.S.2d 606 (Sup. Ct. 1968) 39
O'Keefe v. *Equitable Trust Co.*, 103 F.2d 904 (3d Cir. 1939) 20
Pauly v. *O'Brien*, 69 F. 460 (C.C. S.D. Cal.) (1895) 20
Public Loan Co. v. *FDIC*, 803 F.2d 82 (3d Cir. 1986) 35
Rogers v. *First State Bank*, 79 Colo. 84, 243 P. 637 (1926) 39
United States v. *Kimbell Foods, Inc.*, 440 U.S. 715 (1979) 11, 37, 41, 44, 46
United States v. *Yazell*, 382 U.S. 341 (1966) 37

Statutes:

Banking Act of 1933, ch. 89, § 8, 48 Stat. 168 16
Banking Act of 1935, ch. 614, 49 Stat. 684 17
Federal Deposit Insurance Act, ch. 967, § 2(13), 64 Stat. 888 20
Federal Deposit Insurance Act, 12 U.S.C. 1811 *et seq.* 16
12 U.S.C. 1817 16
12 U.S.C. 1817(a)(2) 3, 16
12 U.S.C. 1818 17
12 U.S.C. 1819 (Fourth) 10, 36
12 U.S.C. 1819 (Eighth) 16

Statutes—Continued: Page

12 U.S.C. 1820(b) 16
12 U.S.C. 1821 ..... 16, 18
12 U.S.C. 1821(c) 17
12 U.S.C. 1821(e) 18
12 U.S.C. 1823(c)(2)(A) 6, 18
12 U.S.C. 1823(c)(4)(A) 19
12 U.S.C. 1823(e) ..... *passim*
National Bank Act, 12 U.S.C. 83 21
U.C.C.:
§ 2-313(1)(a) 44
§ 2-313(1)(b) 44
§ 3-115 at comment 5 44
§ 9-203 46
Uniform Sales Act § 12, 1 U.L.A. 1 (1950) 31
Pub. L. No. 97-320, § 113(m), 96 Stat. 1474 40
12 U.S.C. 161 21
12 U.S.C. 191 17
12 U.S.C. 481 21
12 U.S.C. 1787(i)(2) 13
18 U.S.C. 215 5
18 U.S.C. 1005 ..... 23, 45
18 U.S.C. 1014 ..... 23, 45
La. Civ. Code (West 1952 & Supp. 1987):
Art. 3158 46
Art. 3159 46
Art. 3342 *et seq.* 46

Miscellaneous:

Black's Law Dictionary (4th rev. ed. 1968) 14
Burgee, *Purchase and Assumption Transactions Under the Federal Deposit Insurance Act*, 14 The Forum 1146 (1979) 18
59 C.J.S. *Mortgages* § 99 (1949) 46
93 C.J.S. *Warranty* (1956) 14
79 Cong. Rec. 6808 (1935) 17
96 Cong. Rec. (1950):
p. 10652 29
p. 10653 29
p. 10656 29

Miscellaneous—Continued: Page

p. 10659 29
p. 10662 29
p. 10671 28
p. 10729 29
p. 10731 29
p. 10671 28
pp. 10731-10732 28

A. Corbin, *Contracts* (1963):

Vol. 1 15
Vol. 1A 43

E. Farnsworth & J. Honnold, *Cases and Materials on Commercial Law* (3d ed. 1976) 31
FDIC 1984 Annual Report 6
Holmes, *The Path of the Law*, 10 Harv. L. Rev. 457 (1897) 15
H.R. Conf. Rep. 3049, 81st Cong., 2d Sess. (1950) .. 29
H.R. 1949, 81st Cong., 1st Sess. (1949) 24
H.R. 5811, 81st Cong., 1st Sess. (1949) 24
Hearings on H.R. 5811, Before the House Comm. on the Judiciary, 81st Cong., 1st & 2d Sess. (1949 & 1950) 24, 25, 26
H.R. Rep. 2564, 81st Cong., 2d Sess. (1950) 29
L. Simpson, *Handbook of the Law of Contracts* (2d ed. 1965) 15
S. 949, 81st Cong., 1st Sess. (1949) 24
S. 2822, 81st Cong., 1st Sess. (1949) 26, 27
Amendments to The Federal Deposit Insurance Act, 1950: Hearings on S. 2822, Before the House Comm. on Banking and Currency, 81st Cong., 2d Sess. (1950) 28, 29
S. Rep. 1821, 86th Cong., 2d Sess. (1933) 16
7 C. Zollman, *Banks and Banking* (1936) 20, 39

In the Supreme Court of the United States

OCTOBER TERM, 1986

No. 86-489

W. T. LANGLEY and MARY ANN GRIMES LANGLEY,
PETITIONERS

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR RESPONDENT

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A18) is reported at 792 F.2d 541. The opinion of the district court (Pet. App. A19-A25) is reported at 615 F. Supp. 749.

JURISDICTION

The judgment of the court of appeals was entered on June 25, 1986. The petition for a writ of certiorari was filed on September 23, 1986, and was

granted on January 12, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTE INVOLVED

12 U.S.C. 1823(e) provides as follows:

> No agreement which tends to diminish or defeat the right, title or interest of the [Federal Deposit Insurance] Corporation in any asset acquired by it under this section, either as security for a loan or by purchase, shall be valid against the Corporation unless such agreement (1) shall be in writing, (2) shall have been executed by the bank and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the bank, (3) shall have been approved by the board of directors of the bank or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4) shall have been, continuously, from the time of its execution, an official record of the bank.

STATEMENT

1. In 1980 petitioners bought farm land owned by Leenerts Farms, Inc., in Pointe Coupee Parish, Louisiana.[1] The property was conveyed to petitioners by a cash deed (J.A. 16-23). The deed identifies the property as located inside two tracts of land and gives detailed descriptions of the particular parcels within the two tracts that were conveyed and, in

[1] This case comes to the Court on a grant of summary judgment to the Federal Deposit Insurance Corporation ("FDIC"). Accordingly, we accept petitioners' factual allegations as true for purposes of the appeal.

"save and except" clauses, the acreage that was held by third parties and excluded from the sale (J.A. 18-20). After indicating the total acreage, the deed states that both tracts were subject to numerous mineral leases (involving Chevron, Inc., and John Barton, among others) and to an assignment of all of Leenerts Farms' mineral interests to Don I. Williams (J.A. 20-22). These conditions were also disclosed to petitioners in a title opinion received from their attorney prior to the closing of the transaction (J.A. 7-15).

In negotiating for the purchase of the land, as well as in obtaining financing for the purchase, petitioners dealt primarily with Elmer Landry, President of the Federal Land Bank Association of Opelousas, Louisiana, and Roy E. Caughfield, President of the Planters Trust & Savings Bank of Opelousas, Louisiana (Planters or Bank).[2] Petitioners borrowed a total of $1,800,000 from the two banks—$1,350,000 from the Federal Land Bank of New Orleans (Federal Land Bank); $450,000 from Planters.[3] The purchase price of the land was $1,635,000; with roughly $100,000 of the remaining $165,000 in borrowed funds, petitioners bought a certificate of deposit from Planters (J.A. 66). Both the Federal Land Bank's loan and Planters' loan were secured by mortgages on the Leenerts Farms property.

---

[2] Planters was insured by the FDIC but was not a member of the Federal Reserve System. The FDIC therefore was the Bank's primary federal regulator (12 U.S.C. 1817(a)(2)).

[3] The FDIC's examination report indicates that $455,000 was disbursed (J.A. 66). For purposes of this appeal, we adopt petitioners' figure of $450,000.

The closing of the Planters loan of $450,000 took place on December 19, 1980. In connection with the closing, petitioners executed in favor of Planters a collateral mortgage note, personal guarantees, and a collateral mortgage, which borrowed their descriptions of the mortgaged property from the cash deed (J.A. 24-38) and were unconditional on their face: by their terms, the documents fully obligated petitioners to repay their debt in the manner specified. Planters subsequently renewed the note on January 27, 1982, and again on March 8, 1982. Pet. App. A3.

Despite the apparent completeness of the written instruments, petitioners have alleged that they were induced to accept the payment obligations by various fraudulent representations made orally by Landry and Caughfield. The alleged representations were as follows (Pet. App. A4-A5):

1. That petitioners would have no personal liability on their loans and personal guaranties;
2. That no payments would be due from them until the property was resold;
3. That petitioners "would be provided a purchaser" for the property;
4. That petitioners would "realize a large profit" on reselling the property;
5. That the property consisted of 1,628.4 acres;
6. That the property included 400 mineral acres;
7. That there were no mineral leases on the property; and
8. That the purchase price would be 100% financed.

These alleged oral representations, including those relieving petitioners of their liability and their payment obligations as well as those concerning acreage and mineral rights, were inconsistent with the bank documents. See Pet. App. A5 (petitioners "do not contend" and the court of appeals "has not found, that these alleged warranties or loan terms were contained in the promissory note, guaranty, or mortgage executed by [petitioners]"). Petitioners have further alleged that they provided certain payments characterized as "fees" and "commissions" to both Landry and Caughfield in connection with this transaction (Pet. Br. 4). Specifically, Landry received $16,000 and a note for $24,000 (J.A. 114),[4] and Caughfield received mineral interests in the farm property in return for his participation in the transaction (*ibid.*).

Nothing in the written loan agreements executed by petitioners and Planters discloses the existence or character of any side agreements or understandings that might vary petitioners' payment obligations or the descriptions of the mortgaged property set forth in the loan papers. Nor does any reference to the oral side arrangement appear either in the books or records of Planters or in the board or committee minutes kept by the Bank. For roughly three years following the loan transaction, the FDIC had no knowledge of the alleged representations (Pet. Br. 5; J.A. 63): during that period, the Bank's records would thus have been materially incomplete and misleading.

---

[4] Officers of FDIC-insured banks and officers of Federal Land Bank Associations may be subject to criminal prosecution for agreeing to accept such fees (18 U.S.C. 215).

2. In 1983, petitioners failed to pay the first installment due under the March 1982 note (the note). Planters commenced suit on the note on September 26, 1983 (J.A. 39-45). Petitioners responded by filing a countersuit against Planters, Caughfield, and Landry,[5] alleging that they had been fraudulently induced to sign the note by the various representations made orally in the side arrangement (J.A. 46-54). The two cases were subsequently consolidated in the United States District Court for the Middle District of Louisiana.

On May 18, 1984, the Commissioner of Financial Institutions for the State of Louisiana closed Planters and appointed the FDIC as receiver (J.A. 90). The FDIC immediately implemented a "purchase and assumption" transaction, under which all of Planters' deposit liabilities and most of its assets were transferred to another FDIC-insured bank in the community (the assuming bank) (see 12 U.S.C. 1823 (c)(2)(A)). Because the amount of liabilities greatly exceeded the value of transferred assets, the FDIC paid $36,992,000 to the assuming bank from its deposit insurance fund (see FDIC 1984 Annual Report, Table 123, at 47). In consideration of this cash outlay, the FDIC in its corporate capacity received, among other Planters assets, petitioners' note. The FDIC was then substituted for Planters in the pending litigation.

On June 20, 1985, the district court granted the FDIC's motion for summary judgment on the note

---

[5] Petitioners subsequently amended their complaint to add the Federal Land Bank of New Orleans (now known as the Federal Land Bank of Jackson) as a defendant (J.A. 57).

(Pet. App. A19-A26).[6] The court held that 12 U.S.C. 1823(e) barred petitioners' fraudulent-inducement defense to enforcement of the loan obligation, concluding that the alleged side arrangement with Planters could not alter the terms of facially valid written instruments. The court found it unnecessary to decide whether federal common law required the same result.[7]

3. The court of appeals affirmed (Pet. App. A1-A18). Petitioners conceded that 12 U.S.C. 1823(e) barred them from relying on any of the "promissory" representations as a defense to their written obligation; in particular, they withdrew any claim based on the nonrecourse nature of the loan, the absence of any payment obligation until resale, and the promise to find a subsequent purchaser (Pet. App. A7). They argued, however, that Section 1823(e) did not apply to factual misrepresentations—here, the alleged representations concerning the total acreage of the purchased land and its mineral rights (Pet. App. A7). The court of appeals rejected this proposed distinction between promissory and factual fraud.

---

[6] The motion was made by the FDIC in its corporate capacity, as holder of the note, although the FDIC was also substituted for Planters in its capacity as receiver. Unless otherwise indicated, the FDIC is hereafter referred to only in its corporate capacity.

[7] Subsequently, the district court certified its ruling in favor of the FDIC for appeal. Also, the district court granted summary judgment in favor of the Federal Land Bank, and that judgment was affirmed on appeal (*FDIC* v. *Langley*, 792 F.2d 547 (5th Cir. 1986)). There have been no further proceedings on petitioners' claims against Caughfield, Landry, or the FDIC in its capacity as receiver.

The court pointed out that Section 1823(e) was intended "to ensure that the FDIC may rely on the books and records of an insured institution by requiring that material agreements concerning a loan transaction be set forth in the bank's records" (Pet. App. A9). This requirement that all material terms of a loan appear in the bank's written records is necessary to enable FDIC examiners to carry out their duty to examine banks for soundness as well as to make full information available when the FDIC must determine how to deal with a failed bank (*id.* at A10). To permit petitioners' proposed distinction, the court concluded, would defeat those purposes: "By not insisting that Planters' promises and agreements be included in the loan documents—assurances which [petitioners] concede go to the heart of their loan transaction—[petitioners] lent themselves to a loan transaction that withheld the key aspects of their loan transaction from bank regulators" (*id.* at A12-A13).

The court of appeals noted that the Eleventh and Sixth Circuits have suggested, though not actually held, that a fraudulent factual representation might not be covered by Section 1823(e) (*FDIC* v. *Hatmaker*, 756 F.2d 34, 36-37 (6th Cir. 1985); *Gunter* v. *Hutcheson*, 674 F.2d 862, 867 (11th Cir.), cert. denied, 459 U.S. 826 (1982)). The court observed, however, that this case did not simply involve such "factual fraud." Rather, petitioners relied on factual misrepresentations that were part and parcel of an undisclosed "total side arrangement to vary the terms of their loan" (Pet. App. A16). The court concluded that petitioners' effort "to shift the focus of their defense would create an unacceptable 'end run' around § 1823(e)" (*id.* at A17).

SUMMARY OF ARGUMENT

I. The language of Section 1823(e) readily encompasses all representations relied on in entering into a loan transaction. A factual representation thus relied on is an "agreement" in the nature of a warranty just as a promise is. Moreover, the fraudulent nature of the representation, though it may mean that there is no agreement in the subjective sense, does not alter the fact that, in the commonly used objective sense, there was an "agreement" between the parties.

This interpretation is necessary if the FDIC is to fulfill its mandate. The FDIC is responsible for continual examination of insured banks in order to ensure their safety and soundness; it is also responsible, when an insured bank fails, for determining quickly whether to liquidate the bank (and pay depositors to the limit of the insurance liability) or to arrange for a takeover of the bank. Those functions require that bank examiners be able to rely on the books and records of the bank—to assess the bank's strength, to measure the degree of risk to the deposit insurance fund, and to liquidate the bank's assets, should the need arise. Even before Congress enacted 12 U.S.C. 1823(e) in 1950, federal common law principles barred a debtor from raising defenses to limit the value of a bank asset based on oral agreements with the failed bank or on schemes or arrangements that would tend to mislead bank examiners. Section 1823(e), which supplements the common law principles, serves the same purposes and must be construed to permit FDIC examiners, both while a bank is apparently healthy and when it fails, to treat the bank's assets exactly as they appear on the bank's books.

Because the statute is designed to enable the FDIC to rely on the integrity of bank records as fully and continuously disclosing all material terms of a bank's loans, the statute prohibits use of unrecorded understandings to defeat written obligations, regardless of the bank's fraudulent intent. It also prohibits a debtor from relying on unwritten factual representations as well as unwritten promises. Such representations present no less danger to the integrity of bank records than do promises, and the statutory policy of insisting that material terms of a loan be recorded where examiners can see them applies whatever the term. Moreover, the statute applies regardless of whether the debtor had any actual intent to deceive the examiners and regardless of whether the examiners somehow manage to discover the hidden terms.

II. If petitioners' defense is not barred by Section 1823(e), it is precluded by federal common law. The question whether petitioners have a valid defense to their written note, like all questions of law in a civil action involving the FDIC in its corporate capacity, is governed by federal law (see 12 U.S.C. 1819 Fourth). As the lower courts have uniformly recognized, the existence of Section 1823(e), which forbids the recognition of certain defenses to a written obligation, does not require that federal common law recognize other defenses, such as petitioners'. Section 1823(e) does not eliminate the need to determine whether federal common law permits petitioners' defense.

Federal common law precludes recognition of petitioners' defense to their note for two reasons. First, the defense is barred under this Court's decision in

D'Oench, Duhme & Co. v. *FDIC*, 315 U.S. 447 (1942) (*D'Oench*), which held that a debtor who lends himself to a scheme or arrangement that would tend to mislead bank examiners cannot raise any terms or conditions of that scheme or arrangement as a defense against the FDIC in a suit on the note. The *D'Oench* doctrine applies notwithstanding an allegation of fraud by a co-participant in the scheme. The doctrine not only encourages debtors to insist that all loan terms be recorded in bank records, but reflects the equitable principle that, if a loss is to be incurred as a result of a fraudulent unrecorded arrangement, the loss should fall not on the national insurance fund (and hence on depositors nationwide) but on the person who lent himself to (and could have avoided) the side arrangement.

Second, a uniform rule of federal common law refusing to permit challenges to written obligations based on arrangements not reflected in bank records is warranted under *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 726-727 (1979). Such a rule would protect the nationwide insurance fund by furthering the vital federal policy requiring that the FDIC be able to rely on bank records in performing its functions. And the rule would cause no significant interference with local banking practices, because written instruments are already the norm in the banking world.

ARGUMENT

I. 12 U.S.C. 1823(e) Bars Petitioners' Defense To Their Written Loan Obligation Based On Unrecorded Representations Allegedly Relied On In Assuming The Obligation

Petitioners seek to invalidate their note to the failed bank based on oral statements made by an officer of the bank as part of a side agreement that the note would not mean what it says. They concede (Pet. Br. 12) that the oral agreement itself may not be asserted against the FDIC and that, among the false statements made as part of the agreement, those which were in the form of promises (*e.g.*, the nonrecourse nature of the loan, the absence of any payment obligation until resale, the promise to find a subsequent purchaser) likewise cannot alter the written note.[8] Petitioners contend (Pet. Br. 12-

[8] As petitioners' concession regarding Section 1823(e)'s coverage of promissory fraud makes clear, an agreement within the meaning of Section 1823(e) is not only invalid in the sense that it cannot be enforced; no such agreement is "valid against the Corporation" (12 U.S.C. 1823(e)) in any way that would "diminish or defeat the right, title or interest" (*ibid.*) of the FDIC in the written obligation. Thus, an agreement covered by the statute cannot be asserted to invalidate the written obligation any more than it can be asserted as a separate valid agreement. Otherwise, the prohibition in Section 1823(e) would be readily evaded in virtually every case, because every claim alleging an oral agreement that purports to modify a written obligation could be framed as a claim that the written obligation itself was unenforceable. All of the courts of appeals recognize this, including those which have suggested a distinction between factual and promissory fraud. See, *e.g.*, *FDIC* v. *O'Neil*, 809 F.2d 350, 354-355 (7th Cir. 1987); *FDIC* v. *Hatmaker*, 756 F.2d at 37; *FDIC* v. *Merchants National Bank*, 725 F.2d 634, 639 (11th Cir.), cert. denied, 469 U.S. 829 (1984). See also *FDIC* v. *Rodenberg*, 571

14), however, that some of the statements made by the bank officer (*i.e.*, those concerning acreage and mineral rights) were factual "representations" and, for that reason alone, not "agreements" within the meaning of 12 U.S.C. 1823(e). This argument should be rejected; it is not supported by the statutory language and is inconsistent with congressional policy and the statute's history.

A. Section 1823(e)'s Language Broadly Encompasses All Unwritten Understandings Material To A Written Loan Obligation

Section 1823(e), as applied to a note acquired from a bank by the FDIC, declares that "[n]o agreement which tends to diminish or defeat the right, title or interest of the [FDIC]" in the note "shall be valid against the [FDIC]" unless the agreement is in writing, was executed contemporaneously with the bank's acquisition of the note, was approved by the bank's loan committee or board of directors, and was "continuously, from the time of its execution, an official record of the bank."[9] Contrary to petitioners' suggestion (Pet. Br. 11), this language encompasses fraudulent factual as well as promissory representations relied on by a debtor in making a note to the bank. Such representations are in essence war-

---

F. Supp. 455, 459 (D. Md. 1983) ("To permit the defendant to raise these representations in the defense of fraudulent or negligent misrepresentations—while barring their admission as collateral agreements—would allow the defendant to make an 'end run' around § 1823(e).").

[9] Congress has provided the National Credit Union Administration the same protections when it acquires assets from a failed credit union (12 U.S.C. 1787(i)(2)).

ranties, and "a warranty is an agreement" (93 C.J.S. *Warranty* 556 (1956)).

Under the nearly universal law governing the sale of goods, "[a]ny affirmation of fact or promise" that relates to the goods or "[a]ny description of the goods," if a basis of the bargain, creates a warranty (U.C.C. § 2-313(1)(a) and (b)). See *Black's Law Dictionary* 1758 (4th rev. ed. 1968) (a warranty in a contract is "[a]n undertaking or stipulation, in writing, or verbally, that a certain fact in relation to the subject of a contract is or shall be as it is stated or promised to be"). Commercial law thus recognizes no distinction pertinent here between promissory and factual representations; the mere form of words—whether a description or guarantee or warranty or promise—does not alter the legal effect of the representation. Both promissory and factual representations are warranties and, hence, agreements (once the offer is accepted). Nothing in Section 1823(e)'s use of the term "agreement" suggests a different result when a bank makes representations that become a basis of a bargain about the terms of a loan.

Nor does the fraudulent intent of the bank render a factual representation any less an "agreement" within the meaning of Section 1823(e). As petitioners effectively concede, fraudulent intent in making a promissory representation does not remove the representation from the coverage of Section 1823(e). There is no reason for factual representations to be treated any differently. In any event, one common meaning of the term "agreement" is an objective one, which looks not to the subjective intent of the parties but only to their words and conduct. Thus, "[a]greement consists of mutual expressions; it does not consist of harmonious intentions or states of mind"

(1 A. Corbin, *Contracts* § 9, at 20 (1963)). "An agreement in the broadest sense of the word is a manifestation of mutual assent," and "[t]hough the assent must be mutual it need not be actual in a subjective sense. A real 'meeting of the minds' is not necessary to an agreement * * *" (L. Simpson, *Handbook of the Law of Contracts* § 3, at 2-3 (2d ed. 1965)). See also Holmes, *The Path of the Law*, 10 Harv. L. Rev. 457, 464 (1897) (emphasis omitted) ("[T]he making of a contract depends not on the agreement of two minds in one intention, but on the agreement of two sets of external signs,—not on the parties' having meant the same thing but on their having said the same thing."). An "agreement" in this sense—a sense suited to policies designed to influence conduct and to protect third parties—exists even if one party has fraudulent intent and even though the agreement may not be a legally enforceable contract. Under this common construction of the key term in Section 1823(e), allegedly fraudulent warranties are plainly covered.

B. The Core Functions Of The FDIC Require That The FDIC Be Able To Rely On The Written Records Of Insured Banks

Section 1823(e)'s language must be construed "within the framework of the complex statutory scheme that the FDIC administers" (*FDIC* v. *Philadelphia Gear Corp.*, No. 84-1972 (May 27, 1986), slip op. 5-11). The functions entrusted to the FDIC require that the statutory language be given its broad, objective meaning, one that encompasses all representations relied on by the maker of a note. The FDIC's statutory mission of preserving the integrity of the nation's banking system demands that it be able to rely on the books and records of FDIC-insured banks.

Following the spate of bank runs in the early years of the Great Depression, Congress created the FDIC and the system of deposit insurance in 1933 (Banking Act of 1933, ch. 89, § 8, 49 Stat. 168) to restore confidence in and stability to the nation's banking system. See S. Rep. 1821, 86th Cong., 2d Sess. 2-5 (1933); *FDIC* v. *Philadelphia Gear Corp.*, slip op. 6-8. The statute, as originally enacted and as recodified and renamed in 1950 (Federal Deposit Insurance Act (FDI Act), 12 U.S.C. 1811 *et seq.*), establishes an insurance fund financed by bank premiums (12 U.S.C. 1817) and directs the FDIC to administer the fund and to make payments, within prescribed limits, to depositors in failed insured banks (12 U.S.C. 1821). Recognizing that the protection of depositors and the preservation of depositor confidence depends on the protection of the insurance fund, Congress gave the FDIC and other federal bank regulatory agencies authority to supervise FDIC-insured banks with an eye toward preventing bank failures and their adverse impact on the fund. See *First State Bank* v. *United States*, 599 F.2d 558, 563 (3d Cir. 1979), cert. denied, 444 U.S. 1013 (1980) ("If bank examinations by the FDIC reveal any irregularities or fraud, such examinations, though they may inure incidentally to the benefit of [the] bank, are intended primarily for the [benefit] of the insurance fund.").

The FDIC is empowered to examine any FDIC-insured bank (12 U.S.C. 1819 Eighth and 1820(b)). It may conduct its own examinations or rely on examinations conducted by other federal or state banking authorities (12 U.S.C. 1817(a)(2) and 1820 (b)). If banking regulators discover that a bank is operating in an unsafe or unsound manner, they may take action to curb the offending practices in order

to restore the bank to health (12 U.S.C. 1818); alternatively, the FDIC may decide to protect the fund by terminating the bank's deposit insurance (*ibid.*). Bank examinations are critical to the FDIC's ability to carry out its duties of protecting the integrity of the nation's banking system by helping banks avoid failure and preserving the health of the insurance fund. See 79 Cong. Rec. 6808 (1935) (remarks of Rep. Brown on Banking Act of 1935 (ch. 614, 49 Stat. 684)) ("The constructive results of a thorough examination constitute the best single instrument by which the [Federal Deposit Insurance] Corporation can reduce loss from bank failures.").[10] In turn, effective examinations are not possible if a bank's books and records do not clearly disclose the true value of the bank's assets—if resort to testimony or evidence outside the bank's records is needed to evaluate the health of an insured institution.

In addition to examining and supervising banks on a regular basis, the FDIC is also charged with the responsibility to deal with the failure of insured banks.[11] In the event of a failure, the FDIC must

---

[10] "The Federal Deposit Insurance Corporation is not an institution of charity. It is as much a business proposition as banking itself. Its function is not merely to pay losses in the event insured banks are forced to close. Even more important is its obligation to forestall such losses by building up and supporting its member institutions." 79 Cong. Rec. 6808 (1935).

[11] The FDIC does not have authority to close banks. National banks may be closed only by the Comptroller of the Currency (12 U.S.C. 191), but the Comptroller must appoint the FDIC to serve as receiver for a closed national bank (12 U.S.C. 1821(c)). State banks are closed by state bank regulatory authorities, but the FDIC must act as receiver of a closed

determine which of two statutorily available alternatives it should use to minimize the loss to its insurance fund while preserving confidence in the stability of the banking system. One alternative is outright liquidation of the bank (see 12 U.S.C. 1821). The other is implementation of a "purchase and assumption" transaction (12 U.S.C. 1823(c)(2)(A)), whereby the FDIC arranges for another bank to purchase and immediately to reopen the failed institution, with the FDIC insurance fund paying the assuming bank for the difference between liabilities and assumed assets and then attempting to minimize the loss to the fund by collecting on the assets taken by the FDIC rather than the assuming bank (see *Gunter* v. *Hutcheson*, 674 F.2d at 865-866). The latter option is generally preferable for a number of widely recognized reasons. See *FDIC* v. *Wood*, 758 F.2d 156, 160-161 (6th Cir. 1985), cert. denied, No. 84-1952 (Nov. 4, 1985); *FDIC* v. *Merchants National Bank*, 725 F.2d at 637-638; Burgee, *Purchase and Assumption Transactions Under the Federal Deposit Insurance Act*, 14 The Forum 1146 (1979); see also *Doty* v. *Love*, 295 U.S. 64 (1935). A purchase and assumption transaction protects all bank depositors, whether insured or not; it protects all depositors fully, not merely up to the limit of the deposit insurance; and it avoids the spectre of a closed bank and the corresponding disruption of banking services in the community (*FDIC* v. *Wood*, 758 F.2d at 160-161; *Gunter* v. *Hutcheson*, 674 F.2d at 865-866).

Notwithstanding those advantages, Congress has strictly limited the use of the purchase and assump-

---

state bank if asked to do so by state authorities (12 U.S.C. 1821(e)).

tion option. Because of the overriding goal of protecting the nationwide insurance fund, in almost all cases a purchase and assumption transaction may be implemented by the FDIC only if it is less costly to the insurance fund than a liquidation (12 U.S.C. 1823(c)(4)(A)).[12] If the true value of a bank's assets is not readily apparent to bank examiners, the FDIC will be unable to make the required calculation accurately. As a result, the FDIC may be deterred from adopting the preferred means of dealing with a bank failure or may make the wrong decision, thereby damaging statutory policies and the nationwide insurance fund. Those risks are especially great because the choice between liquidation and execution of a purchase and assumption must be made "with great speed, usually overnight" (*Gunter* v. *Hutcheson*, 674 F.2d at 865) so that the failed bank's doors are not closed for even a single business day.

In short, ensuring that bank records accurately reflect the value of bank assets such as notes is critical to the FDIC's ability to carry out its responsibilities for dealing with bank failures, just as it is critical to the FDIC's ability to carry out its continuing duty to examine and to supervise banks that have not failed.

C. The Background And Legislative History Of Section 1823(e) Demonstrate Congress's Intent That The FDIC Be Able To Rely On Written Bank Records

The judicial and legislative background to Section 1823(e)'s enactment make clear that the provision

---

[12] The FDIC can provide assistance without performing this "cost test" only in the rare instance where it determines that the continued operation of a bank is essential to provide adequate services to that bank's community (12 U.S.C. 1823(c)(4)(A)).

was designed to enable the FDIC to rely on written bank records and to protect the FDIC against all side agreements. The statute should therefore be construed to require, insofar as the FDIC is concerned, that obligors insist that all terms material to their loan obligations be recorded in the bank's records in accordance with the statute's stringent requirements.

1. Even prior to Congress's enactment of the provision at issue in this case in 1950 (FDI Act, ch. 967, § 2(13), 64 Stat. 888), this Court and other federal courts had recognized that both creditors and examiners are entitled to protection against claims not reflected in a bank's books and records. Thus, it had long been established that one who provides a note to a bank under an agreement that it will not be enforced, and thereby enables a bank to misstate the true value of its assets, is liable to a receiver of the bank in an action on the note and is estopped from asserting conditions contrary to the express terms of the note. *E.g.*, *O'Keefe* v. *Equitable Trust Co.*, 103 F.2d 904, 908-909 (3d Cir. 1939); *Pauly* v. *O'Brien*, 69 F. 460 (C.C. S.D. Cal. 1895); see *Bryan* v. *Bartlett*, 435 F.2d 28, 34-37 (8th Cir. 1970), cert. denied, 402 U.S. 915 (1971); see also 7 C. Zollman, *Banks and Banking* § 4738, at 281 (1936) (footnotes omitted) ("Attempts to bolster up the apparent assets of a bank by notes procured from responsible persons under a secret promise by the bank officer negotiating in the matter that the makers will not be held on them are all too frequent and deserve condemnation."). This Court elaborated on and extended this principle of federal common law in *Dietrick* v. *Greaney*, 309 U.S. 190 (1940), and in *D'Oench, Duhme & Co.* v. *FDIC*, 315 U.S. 447 (1942).

In *Dietrick* v. *Greaney*, *supra*, the Court held that the maker of an accommodation note, which was executed to conceal a stock purchase transaction forbidden by a provision of the National Bank Act (12 U.S.C. 83), was estopped from arguing lack of consideration in a suit on the note by the receiver of the payee, a national bank. The Court specifically rejected the argument that it was necessary to prove damage from reliance or otherwise to establish the elements of an equitable estoppel (309 U.S. at 197-199): "It is the evil tendency of the prohibited acts at which the statute is aimed, and its aid, in condemnation of them, and in preventing the consequences which the Act was designed to prevent, may be invoked by the receiver representing the creditors for whose benefit the statute was enacted." The Court observed that the provisions of the National Bank Act that require periodic examinations of and reports by national banks (12 U.S.C. 161, 481) "are designed to insure prompt discovery of violations of the Act and in that event prompt remedial action" (309 U.S. at 195). Refusing to allow the accommodation maker to raise a defense to the note, the Court concluded, was necessary to avoid defeating those disclosure policies and the statutory stock-purchase prohibition (*ibid.*).

In *D'Oench*, the Court, again recognizing that "the integrity of ostensible [bank] assets has a direct relation to solvency" (315 U.S. at 461), prohibited the maker of a note from raising a defense to its enforcement even where the maker had no intent to deceive. After bonds sold by the petitioner to a bank were dishonored when presented for payment, the petitioner executed two notes payable to the bank so that the bank could carry the notes as assets and not show any past-due bonds. Any proceeds from the bonds were to be credited to the notes, but it was agreed,

in a writing evidently not recorded on the bank's books, that the notes would not otherwise be called for payment. When the bank failed, the FDIC in its corporate capacity acquired the notes as collateral for a loan and sued to collect on them.

The Court rejected the petitioner's arguments that it should not be liable on the note because it had received no loan proceeds and it had a written agreement with the bank that the notes would not be enforced. Those ordinary contract defenses could not be raised, the Court held, because the maker had "lent itself" to a scheme or arrangement that would tend to mislead bank examiners and the public (315 U.S. at 460). The maker had participated in an arrangement that operated not only as a deception of bank examiners but also as a continuing inducement to existing creditors of the bank and to those who might become creditors to rely on the note as counting toward the bank's solvency (*id.* at 472-473 (Jackson, J., concurring)).

That creditors or bank examiners may not in fact have been deceived or specifically injured was held to be immaterial: as in *Dietrick*, it was the " 'evil tendency' of the acts to contravene the policy governing banking transactions which lies at the root of the rule" barring the maker's defenses (315 U.S. at 459). See also *id.* at 461 ("The federal policy expressed in the [National Bank] Act, like its counterpart in state law, is not dependent on proof of loss or damage caused by the fraudulent practice."). Nor was it significant that the notemaker's conduct may not have constituted a crime (misstating a bank's assets). The Court stated (*id.* at 460 (emphasis added)):

> [T]he inability of an accommodation maker to plead the defense of no consideration does not

> depend on his commission of a penal offense. The test is whether the note was designed to deceive creditors or the public authority, *or would tend to have that effect.* It would be sufficient in this type of case that the maker lent himself to a scheme or arrangement whereby the banking authority on which respondent relied in insuring the bank was *or was likely to be misled.*

Nor, finally, was it relevant whether the maker intended to deceive anyone; the maker of the note was charged with knowledge of the tendency of its actions to mislead (*id.* at 459).

In short, *D'Oench* established a broad rule protecting FDIC against—and hence deterring borrowers from participating in—any arrangement that is likely to make bank records misleading, even where there are no damages or actual deception of creditors or bank examiners and even where the maker had no intent to deceive. This rule supplemented criminal prohibitions similarly designed to ensure that the FDIC could accurately determine the soundness of insured banks. See, *e.g.*, 18 U.S.C. 1005 and 1014.

2. It was against this background that, as part of the FDI Act, Congress in 1950 enacted the provision now codified at Section 1823(e). While *D'Oench* and its progeny involved debtors who had lent themselves to deceptive arrangements, there was uncertainty about the enforceability against the FDIC of "good faith" unrecorded side agreements. Although the legislative history specifically discussing the new provision is sparse, it is clear that the provision was intended to supplement the *D'Oench* doctrine by providing the FDIC with additional assurance that it could rely on bank records.

The issue apparently was first brought to Congress's attention by Representative Frances E. Walter, a ranking member of the House Judiciary Committee. One of Rep. Walter's constituents, Mr. Alker, had lost a case against the FDIC on the ground that he was estopped from asserting certain oral agreements under *D'Oench*, even though he claimed that he had not "lent himself" to any deceptive scheme or arrangement.[13] Rep. Walter introduced a bill that, in addition to amending certain provisions of the criminal code, would have made the FDIC subject to any defense to a note that a debtor could have raised against the insured bank to whom the note was made (except in cases of actual fraud) (H.R. 5811, 81st Cong., 1st Sess. (1949)). The bill made this protection of debtors (the opposite of what was eventually enacted) retroactive to 1933 and, hence, to Mr. Alker's case.[14]

Hearings on the bill were held on August 10, 1949, and on June 12, 1950. *Hearings on H.R. 5811, Before the House Comm. on the Judiciary*, 81st Cong., 1st & 2d Sess. (1949 & 1950) (unpublished) [here-

---

[13] See *FDIC* v. *Alker*, 151 F.2d 907 (3d Cir. 1945), cert. denied, 327 U.S. 799 (1946). Mr. Alker was persistent in his efforts to reverse his loss. His litigation, which ultimately involved 6 petitions for certiorari and 16 petitions for rehearing to this Court as well as 7 appearances before the court of appeals (excluding rehearing petitions), did not come to an end until 1964 (377 U.S. 920).

[14] Rep. Walter also introduced H.R. 1949, 81st Cong., 1st Sess. (1949), which included the same debtor protection as H.R. 5811 but was referred to the Committee on Banking and Currency rather than the Committee on the Judiciary. A similar bill (S. 949, 81st Cong., 1st Sess. (1949)) was introduced in the Senate.

inafter *H.R. 5811 Hearings*]. The FDIC opposed the bill (*id.* at 60) because it "would encourage secret agreements between a bank and its debtors, which conceivably might be short of actual fraud, to the detriment not only of [the FDIC], but also of general creditors and uninsured depositors" (*id.* at 68) (remarks of Norris Bakke, Associate General Counsel, FDIC). The FDIC explained that insured banks

> are examined by governmental authorities which in turn publish reports and statistics concerning their condition. All of such reports are intended to be and are relied upon by the public generally. This reliance of necessity is based upon what records of the bank disclose and the public invests or deposits its money accordingly. Even the most fundamental principles of honesty, aside from any technical rules governing distribution of property of an insolvent bank, require that these creditors be protected against any arrangements, understandings, or agreements which are not disclosed in the records of the bank and, therefore, would not be reflected in these reports.

Id. at 209 (statement of John Cecil, Counsel, FDIC). Evidently, all other relevant government agencies also opposed the bill (*id.* at 207 (noting opposition of Departments of Justice and Treasury, Federal Reserve Board, Nat'l Ass'n of Supervisors of State Banks)).

Various witnesses and members of the Committee repeatedly expressed similar concerns about the bill and stressed the importance of the FDIC's ability to rely on the written records of the bank as well as the minimal burden a writing requirement would have on banks and their customers. See, *e.g.*, *H.R.*

5811 Hearings 51 ("the insurer, the Federal Deposit people, must rely on what the file shows") (remarks of Rep. Michener); *id.* at 54 ("Do you think that it serves a useful public purpose and facilitates in the bank examiners performing their duties to have a note * * * subject to an agreement that is not in writing?") (remarks of Rep. McCulloch); *id.* at 125 ("What would be wrong with the further inclusion in the bill of the requirement that any agreement entered into be substantially placed on the face of the note by addenda or by other means, so that an examiner, when he hits the bank, sees what is there * * *?") (remarks of Rep. Wilson); *id.* at 156 (testimony that it would not be an "undue burden" if "the law required any extension or any deviation from the exact language on the face of that note to be in writing and attached to it"); *id.* at 177 (same). One bank president testified (*id.* at 189) (remarks of John Kirk):

> [T]he bank examiner is a representative of the public, and he has a right to rely on [the note], and I do not care whether he is an examiner for the F.D.I.C., whether he is an examiner for the Comptroller's Office, or whether he is an examiner for one of the State Departments, I do not care who he is representing, he is still representing the American public and he has a right to know that within the four corners of that note that is all there is, that there is no more.

Rep. Walter's bill never left the Judiciary Committee.

On June 20, 1950, one week after the second of the *H.R. 5811 Hearings*, the House Banking and Currency Committee held hearings on S. 2822, 81st

Cong., 2d Sess., which was to become the FDI Act. Although S. 2822 as introduced contained no provision concerning the protection of the FDIC against unrecorded agreements, Rep. Multer, referring to the recent Judiciary Committee hearings, raised the issue in a question to FDIC Director Cook:

> Mr. Multer. There has been considerable litigation through the years during the existence of the Corporation in which contentions have been made that agreements between the banks and debtors have not been lived up to after the banks were closed down and that the FDIC, in collecting the assets of the bank, was put in a more favorable position than the bank itself would have been and that the FDIC could ignore the agreements with the debtors. I think some legislation has been introduced in a hearing held before another committee of the House on the subject. Can you tell us briefly whether or not there is any objection to putting into this proposed law an amendment to require the FDIC to comply with any such agreements that have been made in good faith and which are properly recorded between the debtors and the banks closed up, or taken over, or merged?
>
> Mr. Cook. I think that statement of yours covered the ground entirely—where you are properly supported by such agreements and not dependent upon oral agreements that have no binding effect. *If the bars are once let down on that, there would not be a safe bank in the United States today, because anybody could claim that so-and-so had happened and there would be no evidence to support it.* * * *
>
> Mr. Multer. I think the policy of your bank is to honor any such bona fide agreement.

> Mr. Cook. We never back away from a bona fide agreement, and when the record is clear we inherit that obligation and stand by it. *We cannot be bound when there is no record.*

Amendments to The Federal Deposit Insurance Act, 1950: Hearings on S. 2822, Before the House Comm. on Banking and Currency, 81st Cong., 2d Sess. 41-42 (1950) (emphasis added) [hereinafter *Hearings on S. 2822*].

The bill that the Banking Committee reported to the House contained the provision that has become Section 1823(e). 96 Cong. Rec. 10671 (1950). The provision went beyond the ideas expressed in the Judiciary Committee hearings by opponents of Rep. Walter's bill and required more than merely a writing to support variations from the text of written obligations; it also required that such a side agreement be executed by the bank and the debtor simultaneously with the execution of the note, that it have been *continuously* an official record of the bank, and that official minutes show that it was approved by the bank's board of directors or loan committee. With one minor change in language (see *id.* at 10731-10732 (changing "simultaneously" to "contemporaneously" in the second requirement)), the Committee provision became law without further discussion in Congress.

The law thus enacted, whose language has not been changed, strikes a careful balance between debtor protection and protection of depositors nationwide (through protection of the FDIC). On the one hand, it precisely delineates the means by which debtors can protect themselves; on the other hand, it enables the FDIC to rely on the bank's records when assessing the true condition of FDIC-insured banks. This strengthening of the FDIC's examination authority

complemented the broadening of that authority that was one of the most important features of the 1950 Act. See *Hearings on S. 2822*, at 31 (remarks of FDIC Director Cook); H.R. Rep. 2564, 81st Cong., 2d Sess. 5 (1950); H.R. Conf. Rep. 3049, 81st Cong., 2d Sess. 3-4 (1950); 96 Cong. Rec. 10652, 10653, 10656, 10659, 10662, 10729, 10731 (1950).

D. Section 1823(e) Bars Petitioners' Reliance On Any Unwritten Representations To Vary The Terms Of Their Written Obligation To The Detriment Of The FDIC

The legislative history, the federal common law principles established by this Court in *D'Oench*, and the basic functions of the FDIC all demonstrate the overriding importance of the integrity of bank records. Section 1823(e) must be construed so that bank examiners (as well as creditors and the general public) may rely on them—and need not make inquiries outside the bank's records—in assessing the bank's strength and the prudence of its lending practices. Under Section 1823(e), all representations and promises and understandings that a debtor relies on in entering into a loan transaction, insofar as the debtor may seek to invoke them against the FDIC, must be put in writing and be available in bank records at all times to bank examiners and the public.

1. The broad purposes of Section 1823(e) require that it be construed to bar use of unrecorded side understandings to support an allegation of fraud in the inducement, just as it bars direct use of such understandings to defeat the FDIC's recovery on a note. Petitioners effectively concede this in urging the Court (Pet. Br. 7-14) to adopt a distinction between claims of fraudulent inducement based on

promissory misrepresentations and those based on factual misrepresentations. Like petitioners, the courts of appeals that have drawn this distinction recognize that, when an unwritten side "agreement" is present, Section 1823(e) not only bars proving the validity of the side agreement but also bars its use to prove fraud in the written agreement. See *FDIC* v. *Hatmaker*, 756 F.2d at 37-38; *Gunter* v. *Hutcheson*, 674 F.2d at 867.

Section 1823(e) declares that agreements that fail to meet its requirements are not "valid against the [FDIC]" in any fashion, not merely that they are deprived of separate contractual force. The statute's purposes clearly make irrelevant the actual subjective intent of the parties to the loan transaction. As we have explained, the statute is designed to enable the FDIC to rely on the records of insured banks, to enable FDIC examiners to "confine their scrutiny to documents found in the bank's official records" (*FDIC* v. *O'Neil*, 809 F.2d at 350). Even the *Gunter* court, in affording the FDIC protection under federal common law (674 F.2d at 865, 869), recognized the vital importance of the FDIC's ability to treat assets as they appear on the books, especially when called upon to make speedy decisions about how to deal with a failed bank. This statutory objective, as well as the incentive the statute gives to debtors to insist that all terms material to a loan properly appear in bank records, would be undermined if any use against the FDIC of an off-the-books agreement, including use to establish fraud, were permitted. As the court of appeals stated in *FDIC* v. *Lattimore Land Corp.*, 656 F.2d 139, 146 n.13 (5th Cir. 1981) "[i]f an obligor may successfully void a note and recoup damages against the FDIC based on a claim of fraudulent

inducement from an unwritten agreement, he will have made an end run around § 1823(e)."

2. The heart of petitioners' effort to narrow the scope of Section 1823(e) is their suggestion (Pet. Br. 7-14), following *Gunter* v. *Hutcheson*, *supra*, and *FDIC* v. *Hatmaker*, *supra*, that factual representations are not "agreements" under Section 1823(e) although promises are. Petitioners are unable to cite a single decision that has turned on the distinction they urge. *Hatmaker* made such a distinction in dicta: the case involved only promissory representations (which the court found covered by Section 1823 (e) and unavailable as a basis for a claim of fraud) (see 756 F.2d at 37-38). Similarly, *Gunter* held the FDIC protected by federal common law against an asserted defense to the written obligation at issue (674 F.2d at 868-874), so its decision on Section 1823(e) was unnecessary to its holding. In any event, petitioners' proposed distinction should be rejected.

The natural legal understanding of the language of Section 1823(e) affords no basis for a distinction, among all the statements that form the basis for a bargain about a banking transaction, between those which are promissory in form and those which are assertions of fact. Both are warranties, as commercial law has long recognized (see Uniform Sales Act § 12, 1 U.L.A. 1 (1950) ("[a]ny affirmation of fact or any promise"); pages 13-14, *supra*), and hence both are agreements. See E. Farnsworth & J. Honnold, *Cases and Materials on Commercial Law* 529 (3d ed. 1976) ("a distinction between representations and promises * * * in a contractual setting is inherently difficult"). To the extent factual or promissory representations are relied on by the debtor, there is no relevant difference in the debtor's

mind at the time of the transaction or later: in either case, the debtor understands his written obligations to be qualified, takes the same steps in reliance, suffers the same injury upon breach or falsity, and seeks the same relief.

Further, virtually every factual representation made in connection with a loan transaction could just as easily have been cast in the more explicitly promissory terms of an express warranty. Thus, Planters' purported "factual fraud"—based on Caughfield's alleged misrepresentation of the farm's acreage and mineral rights—might well have taken the form of a statement, "I assure you that the acreage is * * *." Indeed, as a practical matter, a factual representation later relied on to attack the validity of a written loan obligation is very likely to be part of a broader side agreement, with promises and factual warranties inextricably interwoven.[15]

Central to interpreting Section 1823(e), any distinction between those relied-upon representations which are promissory and those which are factual would be flatly inconsistent with the statute's pur-

---

[15] In *Gunter* itself, the debtors had an intricate, multi-termed undisclosed agreement with the bank that directly contradicted the unconditional nature of their note (674 F.2d at 866 n.5). The Eleventh Circuit has relied on that fact in apparently limiting the scope of *Gunter*'s discussion of Section 1823(e). Characterizing the *Gunter* ruling on Section 1823(e) as a "narrow" one, the court in *FDIC* v. *Merchants Naitonal Bank* (725 F.2d at 639 (emphasis omitted)) described the ruling as applying only where "the parties contend that * * * an asset is invalid and that such invalidity is caused by acts independent of any understanding or side agreement." Under that interpretation, if the invalidity is caused by acts that are part of a hidden understanding or agreement, Section 1823(e) applies. The representations at issue here were concededly part of such a side agreement.

poses and its role in the successful functioning of the FDIC. Any unrecorded representations, if alleged to vary the terms of written obligations, would create for the FDIC precisely the problems that Section 1823(e) seeks to eliminate. The stated value of a bank's loan portfolio is undermined whenever *any* material terms underlying the transaction are withheld, and drawing petitioners' proposed distinction would render the FDIC unable to rely on bank records in evaluating bank assets. Petitioners' distinction would greatly impair the incentive the statute provides debtors to insist that all material understandings be put in writing according to the precisely specified disclosure requirements. Petitioners' proposed distinction would accordingly undermine the FDIC's ability to carry out bank examinations as well as its ability to decide, in necessarily expeditious fashion, how to deal with a failed bank. Ultimately, petitioners' suggestion is simply inconsistent with the core statutory policy of protecting the nationwide insurance fund.[16]

3. Contrary to petitioners' apparent suggestion (Pet. Br. 4-5), the FDIC's knowledge of petitioners' defenses prior to the purchase and assumption of the failed bank is irrelevant under Section 1823(e). There is no language in the statute that makes the

---

[16] The *Gunter* court recognized these threats to federal policy but did so under the guise of federal common law because it thought the language of Section 1823(e) insufficiently broad to encompass factual misrepresentations (674 F.2d at 867-874). As we have noted, the *Gunter* court took an unnecessarily narrow view of the statutory language. In any event, we agree with the *Gunter* court that federal common law must accord the FDIC the protection we urge if Section 1823(e) is found unsuited to the task (see pages 41-46, *infra*).

FDIC's knowledge a cure for an otherwise invalid agreement. The statute requires that a side agreement be in writing, not simply that it be communicated to the FDIC (by telegram, for example, immediately prior to a bank failure). The statute also requires that such an agreement be made contemporaneously with the creation of the asset involved and be reflected continuously on the bank's records from the time it is made. The provision thus specifically excludes the possibility of the sort of after-the-fact cures that petitioners apparently have in mind. These requirements are intended to ensure that bank regulators are able to learn immediately of any agreement that would diminish the value of a bank loan, making it possible for the FDIC to detect and to address problems before a bank has failed and to minimize last-minute surprises when making the necessarily expedited decisions concerning how to deal with a bank when it does fail. Not surprisingly, no court has held that Section 1823(e) is subject to an "actual knowledge" exception. See *FDIC* v. *O'Neil*, *supra*; *FDIC* v. *Merchants National Bank*, *supra*; *FDIC* v. *de Jesus Velez*, 678 F.2d 371 (1st Cir. 1982); but cf. *FDIC* v. *Armstrong*, 784 F.2d 741 (6th Cir. 1986) (rejecting claim of fraudulent inducement where FDIC was without actual knowledge of the claim and, hence, a holder in due course).

4. Aside from *Gunter's* (unnecessary) ruling and the dictum in *Hatmaker*, the lower court decisions strongly support the broad, objective interpretation of Section 1823(e) we are urging. The decisions recognize the breadth of Section 1823(e)'s coverage, the strictness of its requirements, and the policies it is designed to serve; and they have protected the FDIC against a wide variety of defenses based on

undisclosed side agreements. See, *e.g.*, *FDIC* v. *O'Neil*, 809 F.2d at 353 (Section 1823(e) bars debtor's reliance on an unexecuted side agreement that was referred to in the note; the FDIC's "appraisers can confine their scrutiny to documents found in the bank's official records"); *FDIC* v. *Castle*, 781 F.2d 1101, 1107 (5th Cir. 1986) (Section 1823(e) bars defense to guarantee left blank and filled in erroneously by bank; rejecting claim "that the alleged oral agreement takes precedence over the documents reflected in the [failed bank's] records"); *FDIC* v. *Merchants National Bank*, 725 F.2d at 639 (the "FDIC may rely on the books and records of [the failed bank] to establish" the extent of a guarantor's obligation). See also *FDIC* v. *Hatmaker*, *supra*; *FDIC* v. *Gardner*, 606 F. Supp. 1484 (S.D. Miss. 1985); *FDIC* v. *Powers*, 576 F. Supp. 1167 (N.D. Ill. 1983), aff'd, 753 F.2d 1076 (7th Cir. 1984).[17] The terms of the side understandings vary

---

[17] In addition, see *Public Loan Co.* v. *FDIC*, 803 F.2d 82 (3d Cir. 1986) (Section 1823(e) bars defenses based on oral accord and satisfaction); *FDIC* v. *Fonseca*, 795 F.2d 1102 (1st Cir. 1986) (Section 1823(e) bars claim that debtor's obligation was conditioned on third party's payment of one of debtor's notes); *FDIC* v. *de Jesus Velez*, 678 F.2d 371 (1st Cir. 1982) (Section 1823(e) bars defenses based on written agreement withheld from bank records); *Chatham Ventures, Inc.* v. *FDIC*, 651 F.2d 355 (5th Cir. 1981), cert. denied, 456 U.S. 972 (1982) (Section 1823(e) bars defenses based on an oral joint venture agreement); *FDIC* v. *Hoover-Morris Enterprises*, 642 F.2d 785 (5th Cir. 1981) (Section 1823(e) bars claims that debtors had no personal liability under the notes); *Black* v. *FDIC*, 640 F.2d 699, 701 (5th Cir.), cert. denied, 454 U.S. 838 (1981) (Section 1823(e) bars defenses based on oral understanding and "custom of the lending trade" concerning obligation to make further financing); *FDIC* v. *Waldron*, 630 F.2d 239 (4th Cir. 1980) (Section 1823(e) bars defense based

from case to case, but all of the debtors and bank customers involved in those cases were attempting to do exactly what petitioners are trying to do in this case—use a concealed understanding to defeat or to diminish the FDIC's collection on a note. Section 1823(e) should be construed to protect the FDIC against all such understandings.[18]

II. Even If Section 1823(e) Does Not Bar Petitioners' Defense To Their Written Obligation, Federal Common Law Precludes Petitioners From Asserting The Defense

If the Court agrees with our reading of Section 1823(e), it need not consider whether federal common law precludes petitioners from seeking to invalidate their written loan obligation. Even if, however, the Court concludes that Section 1823(e) does not bar petitioners' defense, the judgment of the court of appeals should be affirmed on the alternative ground that the defense is precluded under federal common law. Section 1823(e) does not end the inquiry into what defenses may be asserted against the FDIC; and both precedent and proper analysis require refusal to recognize petitioners' defense.

A. Federal Common Law May Refuse To Permit A Debtor's Defense To A Note Held By The FDIC Even If Section 1823(e) Does Not Bar The Defense

Congress has declared that all civil actions involving the FDIC, at least in its corporate capacity, arise under federal law. 12 U.S.C. 1819 Fourth. In addi-

---

on oral agreement that guarantee only covered certain debts of primary obligor).

[18] Of course, this construction of Section 1823(e) affects only a debtor's claims and defenses against the FDIC. It does not affect petitioners' fraud claims against Landry and Caughfield in this case. See note 7, *supra*.

tion, "[t]his Court has consistently held that federal law governs questions involving the rights of the United States arising under nationwide federal programs" (*United States* v. *Kimbell Foods, Inc.*, 440 U.S. at 726). State law does not apply of its own force to this case. Rather, all questions of law concerning petitioners' liability to the FDIC on their note are questions of federal law. See *FDIC* v. *Philadelphia Gear Corp.*, slip op. 5; *D'Oench, Duhme & Co.* v. *FDIC*, 315 U.S. at 456; see also *United States* v. *Yazell*, 382 U.S. 341, 354 (1966).

It is not disputed that federal law makes the note enforceable in the first place. What is disputed is whether petitioners may assert their defense to the note. Contrary to petitioners' apparent assumption that their defense is available unless federal common law affirmatively eliminates it (Pet. Br. 15-18), the correct question is whether federal common law adopts the defense (because state law does not apply of its own force). Accordingly, when petitioners argue that the existence of Section 1823(e) means that "resort to federal common law is inappropriate" (Pet. Br. 19), not only are they wrong (because resort to federal common law is unavoidable), but they leave themselves without any source of law to supply the defense they wish to assert.[19] Contrary to petitioners' argument (Pet. Br. 15-18), Section 1823(e) cannot "pre-empt the field" of remedies (*Illinois* v. *City of Milwaukee*, 406 U.S. 91, 107 (1972)) and leave no role for federal common law.

---

[19] An affirmative cause of action for a suit by petitioners against the FDIC would similarly have to be found in federal common law.

Section 1823(e) certainly is relevant to determining what defenses petitioners may assert against the FDIC. The statute specifically forbids the recognition of certain defenses. In forbidding those defenses, however, it does not simultaneously—and oddly—require the federal courts to recognize other defenses. The statute does not suggest that *all* defenses found in state law, no matter how contrary to the FDIC's interests, must be recognized; and it does not in any way designate which among the numerous possible defenses that may exist in state law are to be adopted.

More specifically, there is no basis whatever for believing that Congress intended to require the federal courts to recognize any particular defense asserted against the FDIC merely because the defense does not involve an agreement covered by Section 1823(e). This is especially clear if, as we are assuming for purposes of this analysis, Section 1823(e) is insufficiently broad in scope to protect the FDIC against all challenges to written obligations based on off-the-books understandings. There is no suggestion in the legislative history that Congress was trying to limit the FDIC's protection when it wrote and enacted Section 1823(e). Congress's only concern was to increase the FDIC's protection; there is no reason to believe that Congress intended simultaneously to deprive the FDIC of existing protections, including those of the 1942 *D'Oench* decision, which, as a matter of federal common law, had broadly refused to recognize defenses emanating from schemes or arrangements likely to mislead bank examiners. There is simply no evidence that Congress intended to overrule *D'Oench*, to limit the *D'Oench* principles, or to constrict the courts' continuing power to deal with

threats to the FDIC's ability to rely on bank records.[20]

The only courts that have addressed this issue expressly have reached the same conclusion. *FDIC* v. *McClanahan*, 795 F.2d 512, 514 n.1 (5th Cir. 1986); *FDIC* v. *Powers*, 576 F. Supp. 1167, 1171-1172 (N.D. Ill. 1983), aff'd, 753 F.2d 1076 (7th Cir. 1984). Moreover, the lower courts have uniformly recognized that Section 1823(e) does not deprive them of the authority, under *D'Oench* and federal common law generally, to determine what defenses to written obligations to allow debtors to assert against the FDIC in its corporate capacity. See, *e.g.*, *FDIC* v. *Investors Associates X., Ltd.*, 775 F.2d 152 (6th Cir. 1985); *FDIC* v. *de Jesus Velez*, 678 F.2d at 375-376; *Gunter* v. *Hutcheson*, *supra*; *FDIC* v. *Hoover-Morris Enterprises*, 642 F.2d 785 (5th Cir. 1981); see also *FDIC* v. *General Investments, Inc.*, 522 F. Supp. 1061, 1070 (E.D. Wis. 1981); *Dominguez* v. *FDIC*, 90 F.R.D. 595 (D.P.R. 1981); *FDIC* v. *Timbalier Towing Co.*, 497 F. Supp. 912 (N.D. Ohio 1980); *FDIC* v. *Vineyard*, 346 F. Supp. 489, 493 (N.D. Tex. 1972). The courts have also applied *D'Oench* to the FDIC in its receivership capacity, which is not covered by Section 1823(e). See,

---

[20] Any such conclusion might well place the FDIC in a weaker position than its predecessors, the receivers of failed banks or the failed banks themselves before they failed. As the Court recognized in *D'Oench* (315 U.S. at 457-459), bank receivers have long been protected from deceptive schemes and arrangements. And banks have long had such protection. See *Mount Vernon Trust Co.* v. *Bergoff*, 272 N.Y. 192, 5 N.E.2d 196 (1936); *Rogers* v. *First State Bank*, 79 Colo. 84, 243 P. 637 (1926); see also *National Bank of North America* v. *Around the Clock Truck Service*, 58 Misc.2d 660, 296 N.Y.S.2d 606 (Sup. Ct. 1968); 7 C. Zollman, *supra*, § 4783, at 284 n.17.

e.g., *FDIC* v. *Van Laanen*, 769 F.2d 666 (10th Cir. 1985); *FDIC* v. *First National Finance Co.*, 587 F.2d 1009 (9th Cir. 1978). Indeed, many of these decisions preceded Congress's reenactment of the provision at issue here, without change, in 1982 (Pub. L. No. 97-320, § 113(m), 96 Stat. 1474). See *Merrill Lynch, Pierce, Fenner & Smith* v. *Curran*, 456 U.S. 353, 381-382 (1982).

The two decisions of this Court that petitioners rely on (Pet. Br. 15-18), *City of Milwaukee* v. *Illinois*, 451 U.S. 304 (1981), and *Mobil Oil Corp.* v. *Higginbotham*, 436 U.S. 618 (1978), do not suggest a contrary conclusion. The Court there held that the existence of certain statutory remedies prohibited the federal courts from adopting additional federal common law remedies; petitioners here argue the opposite—that the statute somehow authorizes the judicial creation of federal common law defenses that would not otherwise exist. Moreover, the common law rules rejected in *City of Milwaukee* and *Mobil Oil Corp.* would have displaced statutes that reflected Congress's "considered judgment" on the scope of available remedies (*Mobil Oil Corp.*, 436 U.S. at 625) and "occupied the field through the establishment of a comprehensive regulatory program supervised by an expert administrative agency" (*City of Milwaukee*, 451 U.S. at 317). A different and entirely unrelated statute is at issue here; and no comparable congressional judgment or displacement of agency authority or comprehensive remedial scheme is present.

In sum, the federal courts must, as a matter of federal common law, determine whether the federal common law rule entitling the FDIC to enforcement of petitioners' note should be overriden by a federal

common law rule permitting petitioners to assert their defense to the note.

B. Federal Common Law Precludes Petitioners' Defense To Their Note

Federal common law must refuse to permit petitioners to assert their defense to the note for two reasons. First, petitioners' claim falls under this Court's *D'Oench* decision. Second, the three-factor test of *United States* v. *Kimbell Foods, Inc.*, 440 U.S. at 728-729, precludes federal common law adoption of petitioners' defense: there is a strong need for a nationally uniform rule forbidding the enforcement of petitioners' side arrangement against the FDIC; adoption of petitioners' defense would "frustrate specific objectives of the federal program[]" (*id.* at 728); and refusing to allow petitioners' defense would not significantly interfere with local commercial practices.

1. *Petitioners' Defense Is Barred By The* D'Oench *Decision Because Petitioners Lent Themselves To An Undisclosed Arrangement That Was Likely To Mislead Bank Examiners*

This Court's *D'Oench* decision established that a debtor who lends himself to a scheme or arrangement that is likely to mislead bank examiners may not assert against the FDIC any part of the arrangement to diminish the value of his written loan obligation. As we have explained, the *D'Oench* decision has not been overridden by Section 1823(e). It therefore remains valid and binding precedent. Petitioners' defense to their note is barred by the doctrine it established.

Petitioners concede (Pet. Br. 12) that they entered into an unwritten side agreement with Planters. They admit (Pet. Br. 4) that their bargain with the

bank was premised on eight material representations directly relating to the loan transaction, some promissory, some factual, but not one of which petitioners disclosed when the loan was made (or for roughly three years thereafter). (They also admit (J.A. 113-114) to having paid questionable "fees" and "commissions" to bank officials for arranging the transaction.). Petitioners voluntarily "lent themselves" to this elaborate unrecorded arrangement; and pursuant to the arrangement, numerous representations, which petitioners concede go to the very heart of their loan transaction, were not embodied in and, in fact, contradicted the loan documents. This arrangement plainly would tend to mislead bank examiners. Petitioners are accordingly barred under *D'Oench* from now relying on portions of their arrangement to relieve them of their written obligations.

Petitioners' allegation that they were defrauded does not remove their claim from the coverage of the *D'Oench* doctrine. As the Sixth Circuit said in applying the *D'Oench* doctrine in similar circumstances (*FDIC* v. *Investors Associates X., Ltd.*, 775 F.2d at 156 (emphasis added)), "*D'Oench* estops the maker of a note from asserting *any* defense arising out of [a] fraudulent scheme, including representations made by another participant in the scheme." See also *FDIC* v. *Berr*, 643 F. Supp. 357 (D. Kan. 1986); *FDIC* v. *Timbalier Towing Co.*, 497 F. Supp. at 922; *British Columbia Investment Co.* v. *FDIC*, 420 F. Supp. 1217, 1224 (S.D. Cal. 1976). The principles on which *D'Oench* rests make a claim of co-participant fraud immaterial. The *D'Oench* doctrine is designed to protect the FDIC from any scheme or arrangement that would tend to mislead bank examiners; and the threat to the FDIC, and hence to the nationwide system of deposit insurance, exists

regardless of whether the bank has deceived only the examiners or the debtor as well. Fraud by the bank does not alter the fact of knowing participation in a misleading arrangement, and that fact was sufficient in *D'Oench* (315 U.S. at 460-461). The lower courts have consistently recognized the prophylactic nature of the *D'Oench* doctrine (see, *e.g.*, *FDIC* v. *Investors Associates X., Ltd.*, *supra*; *FDIC* v. *Van Laanen*, *supra*; *FDIC* v. *de Jesus Velez*, 678 F.2d at 375; *FDIC* v. *First National Finance Co.*, 587 F.2d 1009 (9th Cir. 1978)), and petitioners could have easily and fully protected their legitimate interests by taking the simple step of insisting that all terms material to their loan be placed in writing. See *Chatham Ventures, Inc.* v. *FDIC*, 651 F.2d 355, 363 n.16 (5th Cir. 1981), cert. denied, 456 U.S. 972 (1982).

Finally, application of the *D'Oench* doctrine to petitioners' case is fully in accord with the equitable principles on which *D'Oench* rests. When a bank fails and the FDIC uses money from the insurance fund to purchase a note and then attempts to collect on the note, the principles embodied in *D'Oench* (and in Section 1823(e)) make clear that the loss should fall, not on the nationwide insurance fund (and hence on innocent depositors across the nation), but on the individual who lent himself to the secret arrangement.[21] 1A A. Corbin, *Contracts* § 197, at 203 (1963) ("Whether there has been fraudulent intent or not, it would be scandalous not to enforce payment of the note, if otherwise any depositor or other creditor would be the loser."). This result sensibly imposes

---

[21] The maker of the note may be able to recover under state law from those who allegedly defrauded him. As between himself and the FDIC, however, the responsibility is his.

the costs on the party who was in a position readily to avoid the difficulty by insisting at the outset that all terms material to the loan transaction appear fully in the bank's records. Cf. U.C.C. § 3-115 at comment 5 ("The loss should fall upon the party whose conduct in signing blank paper has made the fraud possible * * *."); *FDIC* v. *Investors Associates X., Ltd.*, 775 F.2d at 155 n.4. As this Court said in *Dietrick* v. *Greaney* (309 U.S. at 196), "[i]t is a principle of the widest application that equity will not permit one to rely on his own wrongful act, as against those affected by it but who have not participated in it, to support his own asserted legal title or to defeat a remedy which except for his misconduct would not be available."

2. *Federal Common Law Must Decline To Permit Petitioners' Defense In Order To Protect The Federal Deposit Insurance Program*

For many of the reasons we have discussed, consideration of the three factors identified in *United States* v. *Kimbell Foods, Inc.*, 440 U.S. at 728-729, demonstrates that federal common law must refuse to allow assertion against the FDIC of challenges to written loan obligations based on any part of a side arrangement not fully reflected in an insured bank's books.[22] First, there is a strong need for a uniform national bar on such challenges. The FDIC administers a single nationwide insurance fund, and harm to the fund in any part of the nation adversely affects depositors nationwide. Moreover, the burden on bank examiners would be great if, in trying to determine

---

[22] We do not suggest that federal common law should adopt the precise requirements of Section 1823(e).

a bank's assets and liabilities, they had not only to look beyond the bank's books but also to become familiar with what defenses each particular state's law might allow a debtor to assert. The need for uniformity reflected in Congress's enactment of Section 1823(e) is just as great in the common law setting.

Second, as we have explained at length above, permitting defenses to written instruments acquired by the FDIC would impair the FDIC's ability to conduct bank examinations and to deal accurately and expeditiously with failed banks. Moreover, whatever their precise scope, both Section 1823(e) and the *D'Oench* doctrine clearly embody a policy, also reflected in other statutes (*e.g.*, 18 U.S.C. 1005, 1014), demanding that bank records be accurate and complete, so that bank examiners can rely on the written terms of assets held in the portfolios of FDIC-insured banks. This policy protects the FDIC against any arangement by which banks and other debtors hide the true value of bank assets by concealing material condition. Indeed, as the court recognized in *FDIC* v. that diminish their value. The need to be able to ascertain the true condition of a bank from the four corners of bank documents is strongest on the eve of a bank failure, but the FDIC also needs to be able to rely on bank records before a bank reaches desperate condition. Indeed, as the court recognized in *FDIC* v. *MM & S Partners* (626 F. Supp. at 687),

> D'Oench and § 1823(e) demonstrate that there is a policy in federal banking law to the effect that the FDIC should not be bound by anything outside a bank's loan documents when it purchases those documents. * * * Therefore, the policy supporting FDIC protection in collateral agreement situations applies equally to all situa-

> tions in which the maker's defense is based on something, representations or conduct, outside of the note itself.

Recognition of petitioners' defense would impair this policy and "frustrate specific objectives of the federal program[]" (*Kimbell Foods, Inc.*, 440 U.S. at 728).

Third, protecting the FDIC from any attempt by a debtor to challenge a written bank instrument on the basis of a side arrangement not fully reflected in bank records would not "disrupt commercial relationships predicated on state law" (*Kimbell Foods, Inc.*, 440 U.S. at 729 (footnote omitted)). It is standard and prudent banking practice to reduce all material conditions of a bank agreement to writing. This is especially the case with large secured loans such as petitioners'. Indeed, state law, probably universally, requires a writing for such secured transactions, including those involving mortgages. See, *e.g.*, 59 C.J.S. *Mortgages* §99, at 143 (1949) (footnote omitted) ("A binding and valid mortgage of real property must be in writing."); La. Civ. Code arts. 3342 *et seq.* (West 1952 & Supp. 1987) (mortgages); U.C.C. § 9-203 (security interests in personal property); La. Civ. Code arts. 3158, 3159 (West 1952 & Supp. 1987) (pledge). Accordingly, the requirements of federal law that control this case are basically supportive, rather than disruptive, of state interests.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

CHARLES FRIED
Solicitor General

JOHN C. MURPHY, JR.
General Counsel

LAWRENCE G. WALLACE
Deputy Solicitor General

ANN S. DUROSS
Assistant General Counsel

RICHARD G. TARANTO
Assistant to the Solicitor General

LAWRENCE F. BATES
Counsel

JANE ROSSOWSKI
Attorney
Federal Deposit Insurance Corporation

MAY 1987

☆ U. S. GOVERNMENT PRINTING OFFICE: 1987 181483 40356